

1-1-1989

Tortious Breach of the Covenant of Good Faith and Fair Dealing since Foley: Opportunity or Efficiency

Dennis Dollar

Follow this and additional works at: <https://digital.sandiego.edu/sdlr>



Part of the [Law Commons](#)

Recommended Citation

Dennis Dollar, *Tortious Breach of the Covenant of Good Faith and Fair Dealing since Foley: Opportunity or Efficiency*, 26 SAN DIEGO L. REV. 73 (1989).

Available at: <https://digital.sandiego.edu/sdlr/vol26/iss1/4>

This Comments is brought to you for free and open access by the Law School Journals at Digital USD. It has been accepted for inclusion in *San Diego Law Review* by an authorized editor of Digital USD. For more information, please contact digital@sandiego.edu.

Comments

Tortious Breach Of The Covenant Of Good Faith And Fair Dealing Since *Foley*: Opportunity Or Efficiency

California courts have allowed the recovery of tort damages for the breach of the implied covenant of good faith and fair dealing in contracts. A consistent and objective criteria has never been offered to determine the contracts for which these damages are recoverable. This Comment evaluates the present case law in California and presents objective and workable criteria, consistent with prior decisions, which focus on delayed performance as the determining factor in awarding tort damages for the breach of a covenant of good faith and fair dealing.

I. INTRODUCTION

People create new duties for themselves daily. These duties are not imposed by law, social mores, or even individual morality. They are produced by agreements called contracts. Since the duties imposed by contract are the product of consent, the damages for breach are limited by that same consent. These limitations take several forms. First, contract damages are limited by foreseeability since a person could not consent to damages she could not foresee.¹ Second, con-

1. *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145, 151 (1854). See also RESTATEMENT (SECOND) OF CONTRACTS § 351 (1979); CAL. CIV. CODE § 3300 (West 1979 & Supp. 1988).

tract damages are also limited for mental suffering.² Like foreseeability, a person is only held liable for mental suffering in those contracts where mental suffering would be expected in the event of breach. Finally, the most settled limitation is that punitive or exemplary damages are not available in a contract action.³

There is one exception to each of these limitations to contract damages. Extended consequences, mental suffering, and punitive damages are allowable, where the breach of a contract is also a tort.⁴ One type of breach which the courts have recognized as being both a breach of contract and a tort is the breach of the implied duty of good faith and fair dealing.⁵ California first recognized this tortious breach of the covenant of good faith and fair dealing in insurance contracts.⁶ The California Supreme Court stated that every insurance contract contained a covenant of good faith and fair dealing.⁷ It held that this implied covenant was not imposed by consent, but by law. Therefore, the damages were not limited by the parties' consent, but were governed by law, allowing tort remedies.⁸ Courts then extended this implied covenant into the employment⁹ and banking¹⁰ contexts.

In 1984 the California Supreme Court stated that a tortious breach could occur in a commercial contract where the breaching party denied, in bad faith, the existence of a valid contract in *Seaman's Direct Buying Service Inc. v. Standard Oil Co.*¹¹ While the *Seaman's* decision was not based upon the covenant of good faith and fair dealing, it extended the possibility of tortious damages for the breach of a purely commercial contract.¹²

Since *Seaman's*, courts and scholars have frequently discussed how far the decision could extend; seldom has anyone agreed. Some courts have been reluctant to extend the concept of tortious breach.¹³

2. *Wynn v. Monterey Club*, 111 Cal. App. 3d 789, 801, 168 Cal. Rptr. 878, 883 (1980). See also RESTATEMENT (SECOND) OF CONTRACTS § 353 (1979).

3. CAL. CIV. CODE § 3294 (West 1979 & Supp. 1988); RESTATEMENT (SECOND) OF CONTRACTS § 355 (1979).

4. RESTATEMENT (SECOND) OF CONTRACTS § 355 (1979); A. CORBIN, CORBIN ON CONTRACTS § 1077 (1964 & Supp. 1984).

5. See, e.g., *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575, 510 P.2d 1032, 1038, 108 Cal. Rptr. 480, 485 (1973).

6. *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 430, 426 P.2d 173, 176-77, 58 Cal. Rptr. 13, 16 (1967).

7. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16.

8. *Id.* at 433, 426 P.2d at 178-79, 58 Cal. Rptr. at 18.

9. *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

10. *Commercial Cotton Co. v. United Cal. Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985).

11. 36 Cal. 3d 752, 769, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984).

12. *Id.* at 752, 686 P.2d at 1158, 206 Cal. Rptr. at 354.

13. See *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 889, 208 Cal. Rptr. 394, 401 (1984); *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1119, 207 Cal. Rptr. 123, 129

Other courts have extended or interpreted the *Seaman's* decision to cover the bad faith denial of liability under a contract.¹⁴ Each court has offered its rationale for tortious breach of the covenant of good faith and fair dealing. But in *Wallis v. Superior Court*,¹⁵ an appellate court offered the only cogent criteria for confining tortious breach.¹⁶

Developing workable criteria for awarding tortious damages for the breach of the covenant of good faith and fair dealing is of particular concern with the California Supreme Court's recent holdings in *Moradi-Shalal v. Fireman's Fund Ins. Cos.*¹⁷ and *Foley v. Interactive Data Corp.*¹⁸ The *Moradi-Shalal* decision held that third parties may no longer sue insurers under statutory provisions of the insurance code, but must premise their suit on either breach of contract or breach of the covenant of good faith and fair dealing contained within that contract.¹⁹ *Foley*, without adopting criteria for awarding tort damages in contract actions, held that employment contracts will not give rise to tort-based damages for a breach of the covenant of good faith and fair dealing, regardless of the standard eventually adopted.²⁰

This Comment will examine and critique the criteria and the standards that the California courts have offered to explain their decisions. It will then offer an alternative standard, more objective and focused, which will provide the most desirable results from both normative and economic viewpoints. This Comment will also bring an element of cohesion, consistent with the courts' recent rulings, to this seemingly contrary body of law.

(1984); *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

14. *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1170, 226 Cal. Rptr. 820, 829 (1986); *Multiplex Ins. Agency, Inc. v. California Life Ins. Co.*, 189 Cal. App. 3d 925, 939-40, 235 Cal. Rptr. 12, 21 (1987). *Multiplex* has generally not been followed by the courts, and when it has been cited, it is most frequently criticized. See *Elxsi v. Kukje Am. Corp.*, 672 F. Supp. 1294, 1297 (N.D. Cal. 1987).

15. 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984).

16. *Id.* at 1119, 207 Cal. Rptr. at 129.

17. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

18. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988).

19. *Moradi-Shalal*, 46 Cal. 3d at 304-05, 758 P.2d at 68-69, 250 Cal. Rptr. at 127.

20. *Foley*, 47 Cal. 3d at 692, 765 P.2d at 396, 254 Cal. Rptr. at 234.

II. THE HISTORICAL DEVELOPMENT OF BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING IN CONTRACTS

There is implied in every contract a covenant of good faith and fair dealing.²¹ This covenant basically requires each contracting party to refrain from doing anything that would prevent the other party from receiving the benefit of the bargain. The breach of this obligation differs from a breach of contract. Basically, the formation of the contract obligates both parties to perform their respective promises. Each party then has the option of either performing their promises or paying the damages that were foreseeable. However, in breaching the covenant of good faith and fair dealing, the breaching party attempts to avoid both performance of the promise and payment of foreseeable damages without a valid reason or defense.

The California Supreme Court initially recognized tortious breach of good faith and fair dealing in insurance contracts. The court held that an insurer was bound by the covenant of good faith and fair dealing to settle a claim against an insured where a possible judgment could exceed the limits of the insurance policy.²² The court reasoned that security and peace of mind were the purposes underlying insurance contracts. Since the insured contracted for peace of mind, mere contract damages could not compensate the insured for its loss when an insurance company did not deal with third party claims in good faith.²³ Breach of the covenant of good faith and fair dealing was next applied where an insurance company failed to deal with the claims of the insured in good faith.²⁴ The court ruled, in these insurance cases, that the breach of good faith and fair dealing was a tort, as well as a breach of contract, making tort remedies available.²⁵

Tortious breach was next extended to employment contracts. In *Cleary v. American Airlines, Inc.*,²⁶ the appellate court found an em-

21. *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958).

22. *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 431-32, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967). While some claim that the breach of the covenant of good faith and fair dealing is first found in *Comunale v. Traders & General Ins. Co.*, the court there actually based its decision on contract principles and remedies. *Comunale*, 50 Cal. 2d at 661, 328 P.2d at 202.

23. *Crisci*, 66 Cal. 2d at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.

24. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575, 510 P.2d 1032, 1038, 108 Cal. Rptr. 480, 485 (1973).

25. *Crisci*, 66 Cal. 2d at 433-34, 426 P.2d at 178-79, 58 Cal. Rptr. at 18; *Gruenberg*, 9 Cal. 3d at 574, 510 P.2d at 1037, 108 Cal. Rptr. at 485. In fact, *Gruenberg* is the first instance where punitive damages were awarded for breach of the covenant of good faith and fair dealing.

26. 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980). *Cleary*, who had worked for American Airlines for 18 years, was discharged after engaging in certain union organizing activities. He filed suit for wrongful discharge and breach of an oral contract. The trial court dismissed the actions upon defendants' demurrers. The appellate court

ployer liable for tort damages in the breach of good faith and fair dealing.²⁷ A number of cases followed, finding the availability of tortious breach in employment contracts.²⁸ Later, in *Khanna v. Microdata Corp.*,²⁹ and *Koehrer v. Superior Court*,³⁰ the appellate courts sorted through the numerous employment decisions, separating breach of good faith and fair dealing from tortious discharge and simple breach of contract. Both cases identified decisions which had been based on good faith and fair dealing, but were actually distortions of tortious discharge.³¹ Yet, they reaffirmed the applicability of bad faith breach to employment contracts.³²

However, the availability of tort remedies for the breach of the covenant of good faith and fair dealing in the employment context was rejected by the California Supreme Court in *Foley v. Interactive Data Corp.*³³ The court examined many of the criteria which had

reversed, holding that longevity of service and established public policies create an obligation for the employer to terminate only for good cause, and the breach of this obligation gives rise to a valid cause of action for tortious discharge.

27. *Id.* at 454, 168 Cal. Rptr. at 728.

28. *See, e.g.,* *Rulon-Miller v. International Business Mach. Corp.*, 162 Cal. App. 3d 241, 208 Cal. Rptr. 524 (1984).

29. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985). *Khanna* was discharged by Microdata Corp. after he filed suit against the company for commissions he had been promised in luring him away from his previous employer. He subsequently filed suit for breach of contract, wrongful discharge and breach of the implied covenant of good faith and fair dealing. A jury verdict was awarded for *Khanna* on all three causes of action. The appellate court affirmed the verdict, holding that the implied covenant of good faith and fair dealing is breached in employment contracts when the employer engages in bad faith action which is extraneous to the contract, frustrating the employee's beneficial enjoyment of contract rights. *Id.* at 258-65, 215 Cal. Rptr. at 864-67. *See infra* notes 84-85 and accompanying text.

30. 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986). The plaintiffs were discharged from their jobs as apartment managers during the term of their contract. They filed suit for breach of contract, tortious termination, and breach of the covenant of good faith and fair dealing. The actions for tortious termination and breach of the covenant of good faith and fair dealing were dismissed on defendant's motion for summary adjudication. The appellate court upheld the dismissal of the tortious discharge action due to plaintiffs' failure to plead and prove that the discharge was contrary to fundamental public policy. But, the court reversed the dismissal of the breach of good faith cause of action, holding that plaintiffs have stated a valid cause of action where they allege that they had fully performed all duties and conditions within the contract and that the termination was intentionally malicious and done without good cause. *Id.* at 1163-71, 226 Cal. Rptr. at 824-30. *See infra* notes 134-36 and accompanying text.

31. *Khanna*, 170 Cal. App. 3d at 261, 215 Cal. Rptr. at 866; *Koehrer*, 181 Cal. App. 3d at 1167, 226 Cal. Rptr. at 827. For example, *Khanna* and *Koehrer* found that *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980) is better explained as a tortious discharge case.

32. *Khanna*, 170 Cal. App. 3d at 262, 215 Cal. Rptr. at 867; *Koehrer*, 181 Cal. App. 3d at 1169, 226 Cal. Rptr. at 829.

33. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988); *see infra* notes 45-

been proffered by courts and scholars for the extension of tort damages in contract actions. Without adopting any of the proposed standards, the court held that the employment context did not "warrant judicial extension of the proposed additional tort remedies. . . ."³⁴

Tortious breach of contract was next expanded into banking.³⁵ Initially the appellate court declined to find a bank's conduct tortious,³⁶ but later decided that banking contracts contained the same elements of adhesion, public policy, and fiduciary considerations found in insurance contracts.³⁷ The court found these elements sufficiently analogous to insurance and awarded tort damages where a bank exercised bad faith in handling a client's claim. This decision was based upon the court's often repeated concern for the special relationship between the contracting parties.³⁸

The most significant extension of tort damages for the breach of contract was expressed in *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*³⁹ In *Seaman's*, the California Supreme Court held that tortious breach of contract could extend to commercial contracts where one party, in bad faith, denied the existence of a valid contract to avoid liability.⁴⁰ Since this was the first decision extending tort damages for the breach of a commercial contract, the *Seaman's* decision produced a flurry of suggestions delineating criteria for tortious breach of contract. Scholars⁴¹ and courts⁴² struggled to balance the considerations of public policy, objective adjudication, and essential justice in applying *Seaman's*. In *Koehrer*,⁴³ the appellate court, in dicta, extended this new area of bad faith breach to denial of liability as well as denial of the existence of the contract, stating that the differences were virtually indiscernible.⁴⁴

III. *FOLEY V. INTERACTIVE DATA CORP.*

The supreme court's recent holding in *Foley* provided little guidance for the availability of tort remedies for the breach of the covenant of good faith and fair dealing. The difficulties presented by the

53 and accompanying text.

34. *Foley*, 47 Cal. 3d at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234.

35. *Wagner v. Benson*, 101 Cal. App. 3d 27, 161 Cal. Rptr. 516 (1980).

36. *Id.* at 32, 161 Cal. Rptr. at 520.

37. *Commercial Cotton Co. v. United Cal. Bank*, 163 Cal. App. 3d 511, 516, 209 Cal. Rptr. 551, 554 (1985).

38. *Id.*

39. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

40. *Id.* at 767, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

41. See, e.g., Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 Bus. L. News 1, 10-12 (1984).

42. See, e.g., *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984).

43. 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986).

44. *Id.* at 1170, 226 Cal. Rptr. at 829.

covenant of good faith and fair dealing are manifested in the decision, which was delivered by a sharply divided court.⁴⁵ Foley was terminated when he informed his employer that his immediate supervisor was under investigation by the Federal Bureau of Investigation for suspected embezzlement from a prior employer. Following Foley's dismissal, he filed a suit alleging tortious discharge, breach of an implied contract and breach of the covenant of good faith and fair dealing. The trial court sustained a demurrer without leave to amend on all three causes of action, and entered judgment for Interactive Data Corporation, which was affirmed on appeal.⁴⁶ The supreme court granted review in 1985, but it took nearly three years for a decision to be rendered.⁴⁷

The court examined the numerous decisions and the plethora of scholarly criticism which had been offered on the availability of tort damages for the breach of the covenant of good faith and fair dealing. It focused much of its analysis on the special relationship necessary to impose tortious damages for the breach of good faith in employment contracts.⁴⁸ However, it specifically declined to adopt any of the proffered tests, and premised its holding on an evaluation of the "economic dilemma that an insured faces when an insurer in bad faith refuses to pay a claim or to accept a settlement offer within policy limits."⁴⁹

In evaluating the "economic dilemma" faced by the terminated employee, the court recognized that the employee, unlike the insured, could mitigate the damages caused by the breach of contract by seeking employment elsewhere.⁵⁰ The court further stated that there was a difference in the economic harms from which an insured and an employee sought to protect themselves with their respective

45. There were three separate dissenting opinions on the availability of tort damages for the breach of the covenant of good faith and fair dealing in the employment context. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 701, 765 P.2d 373, 402, 254 Cal. Rptr. 211, 240 (1988) (Broussard, J., dissenting in part and concurring in part), *id.* at 715, 765 P.2d at 412, 254 Cal. Rptr. at 250 (Kaufman, J., dissenting in part and concurring in part), *id.* at 723, 765 P.2d at 418, 254 Cal. Rptr. at 256 (Mosk, J., dissenting).

46. *Foley*, 47 Cal. 3d at 662, 765 P.2d at 374, 254 Cal. Rptr. at 212.

47. In fact, as recently as September 26, 1988 it was reported that there were as many as seven separate opinions circulating among the court. *Daily Journal* 1:6 (Sept. 26, 1988).

48. *Foley*, 47 Cal. 3d at 690-92, 765 P.2d at 395-97, 254 Cal. Rptr. at 232-34. For a discussion of the special relationship test see *infra* notes 55-65 and accompanying text.

49. *Foley*, 47 Cal. 3d at 692, 765 P.2d at 396, 254 Cal. Rptr. at 234.

50. *Id.*

contracts.⁵¹ Finally, it reasoned that the economic position of the insurer and employer were significantly different. The insurer diminishes its fiscal resources by paying even a valid claim, where the employer has an economic incentive to retain good employees.⁵² The court "conclude[d] that the employment relationship is not sufficiently similar to that of insurer and insured to warrant judicial extension of the proposed additional tort remedies in view of the countervailing concerns about economic policy and stability"⁵³

The *Foley* decision recognized that there are relationships sufficiently similar to the insurance context to warrant the extension of tort remedies for the breach of the covenant of good faith and fair dealing. Its economic analysis provides guidance for future litigators in the form of argumentation, but it does not provide an objective standard to evaluate the appropriateness of tort remedies for the breach of good faith in non-employment contracts. The decision left open both the availability of tort remedies for the breach of good faith in all non-employment contracts, and the appropriate criteria courts should use in evaluating the availability of those same tortious damages.

IV. THE COURTS PROVIDE CRITERIA FOR EVALUATING BAD FAITH BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING

A number of criteria have been offered to evaluate the appropriateness of tort remedies for the breach of the implied covenant of good faith and fair dealing. Since the California Supreme Court examined many of the criteria in *Foley*, but tacitly declined to adopt or reject any of them, it left the issue of an appropriate standard perhaps more clouded than ever.⁵⁴ Like all scholars who have approached the issue, the court sought to balance the competing interests of the injured parties on the one hand and the needs for economic policy and stability on the other. Three major criteria have been developed which I will call the special relationship test, the *Seaman's* test, and the *Wallis* test.

A. *The Special Relationship Test*

Bad faith breach of the covenant of good faith and fair dealing was initially based upon a special relationship existing between the parties to a contract. The supreme court, in *Crisci v. Security Insur-*

51. *Id.*

52. *Id.* at 693, 765 P.2d at 396, 258 Cal. Rptr. at 234.

53. *Id.*

54. *Foley*, 47 Cal. 3d at 654, 765 P.2d at 323, 254 Cal. Rptr. at 211.

ance Co.,⁵⁵ ruled that a special relationship existed between an insurer and an insured since the purpose of an insurance contract was to provide security and peace of mind.⁵⁶ The court found that the existence of the special relationship between the insured and the insurer made tort damages appropriate for the breach of the covenant of good faith and fair dealing, which is implied in every contract.⁵⁷ This rationale, however, fails to answer a number of criticisms.⁵⁸ First, the special relationship test focuses upon contract formation by emphasizing the relative bargaining strength of the parties. This can easily lead to a blurring of the distinction between unconscionability and bad faith breach. Often the courts have resorted to distortion of existing doctrines to support a judgment upholding basic justice. This distortion not only clouds the underlying reason for the case at hand,⁵⁹ but also sets dangerous precedent.⁶⁰ If the actions of the breaching party support the decision, it is better to identify those actions than to attribute the outcome to the posture of the parties at the time of formation.

A second problem with the special relationship standard appears in the assignment of contract actions. Bad faith breach of the covenant of good faith and fair dealing initially developed in third party actions.⁶¹ Since the courts had previously ruled that contract actions

55. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

56. *Id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19. This emphasis on the special relationship between an insurer and its clients also assumes that all insurance transactions are for peace of mind, not commercial benefit. There are a number of commercial transactions that require insurance of one sort or another to secure beneficial treatment. For example, in order to receive a Federal Housing Administration (F.H.A.) loan, the borrower must buy private mortgage insurance. The borrower in this case is contracting for insurance in order to receive the favorable interest rates available through the F.H.A. Further, the legislature enacted California Vehicle Code sections which require all drivers to have proof of financial responsibility, and essentially mandated liability insurance for all drivers. CAL. VEH. CODE §§ 16021, 16028 (West 1971 & Supp. 1988). These are just two examples showing that insurance might be procured either for commercial advantage or from fear of prosecution. If the court is resting its analysis upon the purpose of insurance, it should require the insured to prove that the reason for obtaining insurance was primarily for security and peace of mind.

57. *Crisci*, 66 Cal. 2d at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16.

58. For a good discussion of the special relationship criteria see Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CAL. L. REV. 1291, 1298-1301 (1985); Putz & Klippen, *Commercial Bad Faith: Attorney Fees Not Tort Liability is the Remedy for 'Stonewalling'*, 21 U.S.F. L. REV. 419, 478-79 (1987).

59. See *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1163, 226 Cal. Rptr. 820, 824 (1986).

60. Cf. Llewellyn, Book Review, 52 HARV. L. REV. 700, 703 (1939) (discussing the covert distortion of other doctrines instead of overtly recognizing unconscionability).

61. *Crisci*, 66 Cal. 2d at 428, 426 P.2d at 175, 58 Cal. Rptr. at 15.

were freely assignable, the court had little trouble approving assignment of bad faith breach actions to a third party.⁶² However, if the primary reason underlying the availability of tort damages in a contract action is the relationship between the insurer and the insured's peace of mind, it is a bold step to allow the random victim of an accident to sue the insurer.⁶³ Instead of examining the actions, damages, and positions of the parties in reliance on the contract, which would provide a more appropriate measure for both liability and damages, the special relationship model emphasizes the parties' relationship at the time of formation.

The California Supreme Court discussed at length this special relationship test in *Foley*.⁶⁴ The court recognized many of the inherent problems that this test presents and declined to specifically adopt the test, premising its analysis instead on the speculation of the result such a test would produce "if we were to assume that the special relationship model is an appropriate one to follow in determining whether to expand tort recovery"⁶⁵ Thus, the court recognized the difficulty that judges and scholars have grappled with in the evaluation of tort remedies for breach of the covenant of good faith and fair dealing, based merely upon a special relationship analysis.

B. The Seaman's Test

The *Seaman's* decision offered two other standards for the extension of tort damages for breach of contract, one by the majority and another by Chief Justice Bird, concurring and dissenting. The majority found that the denial, in bad faith, of the existence of a valid contract to avoid liability made tort damages available, even in commercial contracts.⁶⁶ This standard emanated from prior decisions holding that neither party could do anything that would prevent the other from receiving the benefits of the agreement.⁶⁷ The majority ruled that tort damages were appropriate because, "[s]uch conduct goes beyond the mere breach of contract. It offends accepted notions of business"⁶⁸ While at first blush this appears to benefit the non-breaching party, this standard serves only as a trap for the un-

62. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 15.

63. *Id.*

64. *Foley*, 47 Cal. 3d at 690-92, 765 P.2d at 395-97, 254 Cal. Rptr. at 232-34.

65. *Id.* at 692, 765 P.2d at 395-96, 254 Cal. Rptr. at 233-34.

66. *Seaman's Direct Buying Serv. Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 767, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984). The court did not base the tort damages upon the breach of the covenant of good faith and fair dealing, but "it is difficult otherwise to understand its repeated reference to 'good faith' and 'bad faith'. . . ." *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1170, 226 Cal. Rptr. 820, 829 (1986).

67. *Seaman's*, 36 Cal. 3d at 766, 686 P.2d at 1167, 206 Cal. Rptr. at 360.

68. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363.

wary in pleading.⁶⁹ Ex ante this standard supplies no incentive for the breaching party to comply with the terms of the contract. The court reasoned that the denial of the existence of a contract in bad faith was abhorrent to accepted business practices, yet its decision did nothing to stop the breaching party from stipulating to the existence of a valid contract, but denying all liability under that contract.

Chief Justice Bird, who wrote separately in *Seaman's*, and concurred in part and dissented in part, offered the second standard. Bird argued that "[a] breach of contract may also constitute a tortious breach of the covenant of good faith and fair dealing in a situation where the possibility that the contract will be breached is not accepted or reasonably expected by the parties."⁷⁰ Under this standard, tortious damages would be available if, at the time of formation, there was an express understanding that a breach would not be permitted, or if the parties recognized that contract damages would either be unavailable or inadequate to compensate the injured party.⁷¹ In attempting to extend tortious breach into the commercial arena by this standard, Bird, much like the majority, ignored the traditional reasoning which supported the breach of good faith and fair dealing. Traditionally, tortious breach was granted in cases where contracts were characterized by public interest, adhesion, and fiduciary responsibility. One of the reasons that bad faith in these contracts brought tort damages was that the parties in these contracts typically possessed unequal bargaining power.⁷² Yet by allowing the parties to come to express understandings regarding the availability of breach and damages, the party in the superior bargaining position can add recitals allowing either for contract or tort damages in the event of a breach. Thus, the *Seaman's* court, in attempting to extend the rationale for bad faith breach, actually offered two standards that posed a trap for the unwary. The majority offered a trap for the unwitting pleader, while Bird's snare is set for the unwary contract draftsman. Neither standard protects the par-

69. Note in *Koehrer*, the appellant was careful not to deny the existence of a valid contract. *Koehrer*, 181 Cal. App. 3d at 1162, 226 Cal. Rptr. at 823. For these reasons, the second district has held that the *Wallis* test, discussed *infra*, should be applied to limit the *Seaman's* tort. *Okun v. Morton*, 203 Cal. App. 3d 805, 825-26, 250 Cal. Rptr. 220, 233 (1988).

70. *Seaman's*, 36 Cal. 3d at 780, 686 P.2d at 1174, 206 Cal. Rptr. at 370 (Bird, C.J., concurring and dissenting).

71. *Id.*

72. *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1117, 207 Cal. Rptr. 123, 127 (1984).

ties that the courts traditionally sought to protect.

C. *The Wallis Test*

The most comprehensive standard for bad faith breach was rendered in *Wallis v. Superior Court*.⁷³ The appellate court required five criteria for a tortious breach:

- (1) the contract must be such that the parties are in inherently unequal bargaining positions;
- (2) the motivation for entering the contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection;
- (3) ordinary contract damages are not adequate because
 - (a) they do not require the party in the superior position to account for its actions, and
 - (b) they do not make the inferior party "whole";
- (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and
- (5) the other party is aware of this vulnerability.⁷⁴

The *Wallis* criteria attempt to give a sound and objective basis for decisions. One aspect of this standard is troublesome however; the requirement of a non-profit motivation for entering a contract is either an assumption or a conclusion which is effective to achieve a desired result.⁷⁵ As such, it requires the judge to evaluate a very subjective matter, which will often be determined by the level of abstraction at which it is viewed.

For example, in *Wallis*, the plaintiff had been employed by a furniture manufacturer for thirty-two years. When the firm closed its plant a written agreement was executed, calling for the firm to pay Wallis \$568.90 per month until he reached age sixty-five. Wallis, in exchange, promised not to compete with the firm's business. Three years later, the company discontinued payments under the agreement.⁷⁶ The court, in evaluating this contract, held that, "plaintiff entered the contract to secure financial stability and peace of mind."⁷⁷

In contrast, another court denied tort damages to an independent trucking company in *Quigley v. Pet, Inc.*⁷⁸ An independent hauler contracted to transport nuts for Pet. The *Quigley* court found that, "[t]he contractual relationship was entered into for the usual busi-

73. *Id.* at 1119, 207 Cal. Rptr. at 129.

74. *Id.*

75. Cf. Sullivan, *Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207, 226-40 (1977) (discussing the special relationship requirement to establish liability).

76. *Wallis*, 160 Cal. App. 3d at 1113, 207 Cal. Rptr. at 125.

77. *Id.* at 1120, 208 Cal. Rptr. at 129.

78. 162 Cal. App. 3d 877, 891, 208 Cal. Rptr. 394, 402 (1984). While on its face this case could be distinguished from *Wallis* since the contract was between two corporations, the court rejected this type of reasoning in *Foley*, 47 Cal. 3d 654, 692-93, 765 P.2d 373, 396, 254 Cal. Rptr. 211, 234 (1988).

ness reason of profit.”⁷⁹ While there are some differences in being paid for a covenant not to compete, and a contract to haul nuts, it does not seem consistent to find that one party sought security while the other pursued commercial advantage. Both parties entered into their contracts to receive assurance that their performance would trigger the responsibility of a corporation to pay money. The difference in the treatment of these cases is more properly explained by the vulnerability created by non-simultaneous performance. Wallis was asked to give up his livelihood in exchange for monthly payments made over ten years. Quigley, on the other hand, contracted to haul walnuts, in exchange for regular payments.

Another case which demonstrates the subjective nature of the *Wallis* non-profit criteria is *Bodenhamer v. Superior Court*.⁸⁰ In *Bodenhamer*, a jeweler purchased insurance to protect his business. When he submitted a claim, St. Paul Fire and Marine Insurance Co. prolonged the processing. The court found that if St. Paul breached the covenant of good faith and fair dealing, an award of tort damages for the ruin of the jeweler’s good business name would be available on remand.⁸¹ Under the *Wallis* criteria, this claim would not have been allowed because Bodenhamer’s purpose in securing insurance was to protect a mere commercial interest.

A second problem with the *Wallis* criteria is the requirement of unequal bargaining power. This standard evolved from the special relationship standard discussed earlier.⁸² Like special relationships, the unequal bargaining power requirement focuses upon the time of contract formation. An action for bad faith tortious breach should focus not on formation, but on those actions and situations where the conduct of the breaching party is sufficiently grievous to warrant tortious damages. Curiously, one court has found that the party weaker at the time of formation is in a superior position to pursue a suit for breach of contract.⁸³

A greater problem with the *Wallis* criteria is that it fails to account for a number of decisions that the courts have rendered. In *Khanna v. Microdata Corp.*,⁸⁴ the plaintiff was lured away from a

79. *Quigley*, 162 Cal. App. 3d at 893, 208 Cal. Rptr. at 403.

80. 192 Cal. App. 3d 1472, 238 Cal. Rptr. 177 (1987).

81. *Id.* at 1475, 238 Cal. Rptr. at 178.

82. See *supra* notes 55-65 and accompanying text.

83. It found that “litigation . . . against a financially formidable opponent . . . assured plaintiffs a full recovery of any contract judgment.” *Quigley*, 162 Cal. App. 3d at 893, 208 Cal. Rptr. at 403.

84. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).

lucrative position to accept a job with Microdata. He was attracted by the promise of a very profitable account. After changing employers, however, Microdata tried to alter the terms of the agreement. When Khanna filed suit to recover the benefits of his agreement, Microdata fired him. The court found sufficient evidence to warrant a finding of breach of the implied covenant of good faith and fair dealing.⁸⁵ Under the *Wallis* criteria, the court must find that the purpose of the contract was not for profit. While a judge might be willing to analogize an employment contract to a contract for early retirement, the facts leave little doubt that Khanna's purpose in securing the contract was to profit from the lucrative account that he was promised.

Another decision that poses problems for the *Wallis* criteria is *Commercial Cotton Co. v. United California Bank*.⁸⁶ This was the first case in California which extended tortious breach of the covenant of good faith and fair dealing into the banking contract. In *Commercial Cotton*, Travis Calvin, the principal shareholder of Commercial Cotton Co., did not discover, for nearly two years, that a \$4,000 forged check was charged against his account. When Calvin discovered that the check was negligently paid against his account, he notified the bank and asked it to return the money. The bank refused to reimburse Calvin, stating that the claim was barred by a one-year statute of limitations, despite the fact that eleven days earlier United California Bank had lost a case on that very point.⁸⁷ The court awarded punitive damages to Calvin even though no physical or emotional damages could be shown.⁸⁸ The court specifically found in this case that the plaintiff contracted with the bank for security and ease of transactions. Because the account was a non-interest bearing checking account, the court held that no profit motive was present.⁸⁹ On its face, this case meets the *Wallis* criteria. However, if the bank dealt in exactly the same manner with another depositor, but the problems arose in an interest bearing account, the extended damages available under *Commercial Cotton* would not be available to them.⁹⁰

85. *Id.* at 264, 215 Cal. Rptr. at 868.

86. 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985).

87. *Id.* at 515, 209 Cal. Rptr. at 553 (citing *Sun 'N Sand, Inc. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978)).

88. The court in fact overturned damages for emotional distress which had been awarded at trial since no proof was offered indicating that the emotional distress was severe or substantial. *Id.* at 517, 209 Cal. Rptr. at 555.

89. *See id.*

90. The problems stemming from an interest bearing account could cause actual provable tort damages which the injured party could recognize in much less than two years, unlike *Commercial Cotton* (where it took Calvin over two years to discover his loss), yet not have these tort damages available to them because of a mere five percent interest payment.

Most importantly, the *Wallis* criteria fail to explain the very decision they were based upon, *Seaman's*.⁹¹ The plaintiff in *Seaman's* negotiated a requirements contract with Standard Oil, so it could qualify to lease a marine fueling station. Once *Seaman's* entered the lease in reliance upon the negotiated contract, Standard Oil refused to comply with the terms, denying the existence of a contract. While the court in *Seaman's* claimed not to base its decision on good faith and fair dealing, much discussion was devoted to the concept.⁹² Under the *Wallis* criteria, *Seaman's* would have been unable to recover tort damages because the primary purpose of its contract was to establish a profitable business. The *Wallis* criteria could only be met by arguing that the purpose of the contract was security regarding the availability of fuel. However, this argument illustrates the subjective nature of this standard, for every contract at some level of abstraction is concerned with security.

Both the non-profit standard and the unequal bargaining criteria, as shown in the cases above, present subjective terms which the judge is allowed to mold to accomplish basic justice. One of the themes of modern contract law is the move towards objective adjudication.⁹³ Objective standards promote certainty both for the case at hand and as precedent for future decisions. Therefore, a more objective standard for bad faith breach is desirable.

V. THE DELAYED PERFORMANCE STANDARD

This Comment proposes an alternative standard for the evaluation of tortious breach of the implied covenant of good faith and fair dealing. This standard, called the delayed performance standard, has four criteria for a tortious breach of the covenant of good faith and fair dealing:

- (1) there must be a binding contract calling for non-simultaneous performance;
- (2) the performing party, relying upon the terms of the contract, must fully perform or so substantially perform that it leaves that party in an absolutely vulnerable position;

91. *Wallis*, 160 Cal. App. 3d 1109, 1116, 207 Cal. Rptr. 123, 127 (1984) (holding that the plaintiff was in a position sharing similar characteristics to insurance contracts, as was "intimated" in *Seaman's v. Direct Buying Serv. Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 362 (1984)).

92. See *supra* note 66.

93. See A. CORBIN, CORBIN ON CONTRACTS § 106 (1964 & Supp. 1984) (discussing the rise of the objective theory of contracts).

(3) the performing party must be left without adequate self-help or contract remedies, in the event of breach; and

(4) the breaching party, in bad faith⁹⁴ and aware of the vulnerability and the inadequacy of remedies, adopts a "stonewall" or "see you in court" position.

A. A Binding Contract

Tortious breach of the implied covenant of good faith and fair dealing should require the existence of a binding contract. The courts have often stated that this covenant is implied in law in every agreement,⁹⁵ though not a part of the actual agreement. Good faith and fair dealing is implied to assure that neither party to an agreement will interfere with the other's right to receive the benefits of that agreement.⁹⁶ The supreme court has stated that it is possible for the parties to shape the nature and context of this covenant, though no party can exclude it from any agreement.⁹⁷ With the advent of promissory estoppel⁹⁸ and U.C.C. gap-filling provisions,⁹⁹ there are currently sufficient protections for a party which has substantially negotiated a contract, and for a party which has extensively relied upon representations during negotiations.¹⁰⁰ By restricting this implied covenant to binding contracts, the courts can preserve the right of the parties each to consent to the duty and to have an opportunity to mold the duty to deal fairly with one another. Furthermore, this requirement will provide an economy of action by limiting litigation to parties that were privy to the contract.¹⁰¹

94. This Comment does not propose to examine the exact criteria for bad faith. For the purpose of this Comment, bad faith exists when a party to the contract does not have reasonable belief in or reasonable grounds for asserting a claim. For a good discussion of bad faith, see Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968); Summers, *The General Duty of Good Faith - Its Recognition and Conceptualization*, 67 CORNELL L. REV. 310 (1982). But see Burton, *More of a Good Faith Performance of Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1984).

95. See, e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967).

96. *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958).

97. *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 686 P.2d 1158, 1166, 206 Cal. Rptr. 354, 363 (1984).

98. *Drennan v. Star Paving Co.*, 51 Cal. 2d 409, 413, 333 P.2d 757, 759 (1958).

99. See, e.g., CAL. COM. CODE §§ 1204, 2305 & 2308 (West 1964 & Supp. 1988).

100. But see Comment, *Reconstructing Breach of the Implied Covenant of Good Faith and Fair Dealing as a Tort*, 73 CALIF. L. REV. 1291, 1316-18 (1985) (stating that the tort of breach of the covenant of good faith and fair dealing should replace promissory estoppel).

101. Cf. *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 46 Cal. 3d 287, 301, 758 P.2d 58, 66, 250 Cal. Rptr. 116, 124 (1988) (discussing the plethora of litigation spawned by allowing third parties to sue under the California Insurance Code).

The requirement of a binding contract is not a supplement to the statute of frauds. Courts have long recognized the validity of both oral and implied-in-fact contracts.¹⁰² Likewise considerable scholarship has been expended by the courts¹⁰³ and scholars¹⁰⁴ in elucidating the factors necessary to find a binding contract, whether written, oral, or implied. For the purposes of the delayed performance standard, a binding contract is an agreement containing all legal requirements, between two parties with sufficient particularity to indicate that a reasonable person would conclude that an enforceable contract has been formed.

B. Non-simultaneous Performance

Tort damages are particularly appropriate for contracts that call for non-simultaneous performance, since the courts have treated such contracts quite differently. The courts have refused to apply anticipatory breach, thereby accelerating payment, where one party has fully performed and merely awaits payment in money.¹⁰⁵ According to the courts' reasoning, the parties bargained for their own deal, and therefore the courts will not accelerate the payment called for under the contract. Also, the courts, recognizing the vulnerability of non-simultaneous performance, have refused to specifically enforce a contract against a party required by the contract to perform first, absent adequate security for counter-performance.¹⁰⁶ On the one hand, self-help is no longer available to the party who has fully performed,¹⁰⁷ yet the courts will not allow that party to sue for performance not yet due. The party who has fully performed is left to await the possibility of further legal proceedings. On the other hand, the courts will not allow the party who has fully performed to sue for specific enforcement in contracts calling for non-simultaneous performance where there is inadequate security for that party's protection. These two differences demonstrate the courts' recognition of the need for such contracts, but the inherent vulnerability which they

102. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 675-82, 765 P.2d 373, 383-88, 254 Cal. Rptr. 211, 221-26 (1988).

103. *Id.*

104. *See, e.g., Note, Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335 (1974).

105. *Minor v. Minor*, 184 Cal. App. 2d 118, 122, 7 Cal. Rptr. 455, 457 (1960).

106. RESTATEMENT (SECOND) OF CONTRACTS § 363 (1979).

107. Self-help is a term used to indicate those remedies available to an early performing party, without resorting to court action. Such remedies include mitigation, withholding counter performance, and the U.C.C. concept of cover.

produce.

This vulnerability has concerned the courts in many of the good faith and fair dealing cases, however, it has never been adequately defined.¹⁰⁸ It has at least impliedly been an extension of the special relationship standard.¹⁰⁹ However, in each of these good faith and fair dealing cases, this vulnerability has been molded to fit the substantial justice desired in the individual situation.¹¹⁰ Yet, in each of the cases where the requisite vulnerability was found, the contract called for non-simultaneous performance. For the purposes of the proposed standard, full performance and substantial performance both satisfy this requirement for vulnerability.¹¹¹ This definition of vulnerability focuses on the positions and the acts of the parties at the time of breach, not at the time the contract was formed.

C. Inadequate Remedy

Under the delayed performance standard, tort damages would only be available where contract remedies are inadequate, self-help is unavailable, and both parties are aware of this situation. A thorough understanding of these criteria eliminates many of the concerns that followed the extension of tort damages into commercial contracts.¹¹² In a contract between two commercial parties, contract damages will normally be adequate to compensate the injured party. Traditional contract damages give the injured party money damages plus interest sufficient to put that party in the position they would have been in had the contract been fulfilled.¹¹³ Most commercial parties diver-

108. See, e.g., *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1120, 207 Cal. Rptr. 123, 129 (1984) (vulnerability is stated as a requirement but then never fully investigated though factors were available that would have made such an evaluation enlightening). See also *Foley v. Interactive Data Corp.*, 47 Cal. 3d at 692, 765 P.2d at 396, 254 Cal. Rptr. at 234 (in evaluating the possibility of a special relationship the court described the predicament of the insured as an economic dilemma).

109. *Seaman's Direct Buying Serv. Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 768, 686 P.2d 1158, 1162, 206 Cal. Rptr. 354, 362 (1984).

110. Compare the difference in treatment of two corporations in *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 208 Cal. Rptr. 394 (1984) and *Seaman's Direct Buying Serv. Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 173, 206 Cal. Rptr. 354 (1984).

111. Substantial performance is a concept that has already been employed in contract law, often to avoid gamesmanship. *Posner v. Grunwald-Marx*, 56 Cal. 2d 169, 186, 363 P.2d 313, 323, 14 Cal. Rptr. 297, 308 (1961).

112. See, e.g., Hayes, *Punitive Damages in Breach of Contract Actions: An Analysis of the Implied Covenant of Good Faith and Fair Dealing*, 7 NORTHROP U. L.J. AEROSPACE BUS. & TAX'N 67 (1986).

113. There has been a suggestion to award attorney's fees in all of these cases as well. Note, "Contort": *Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts - Its Existence and Desirability*, 60 NOTRE DAME L. REV. 510, 527-28 (1985). However, at present, all parties have the right to negotiate the attorney's fees provisions in any contract they draft, so each party already has at their disposal the ability to protect themselves against the costs of litigation. Furthermore, this approach would increase the transaction costs inherent in contract dis-

sify their dealings to avoid total vulnerability.¹¹⁴ But in those businesses where diversification is not possible or efficient, the extension of tort damages will not thwart the agreements of commercial parties. Instead the parties merely will be forced to internalize the costs of breach.¹¹⁵

VI. APPLYING THE DELAYED PERFORMANCE TEST

A. *The Insurance Context*

The delayed performance standard explains prior court decisions better than the alternative criteria presented by courts and scholars. Few contracts require people to fully perform without any security guaranteeing counter-performance. But insurance contracts, by their very nature, require that the insured fully perform by paying all premiums while awaiting counter-performance in the event of a claim. The special relationship model relied upon the purpose of insurance to justify tort damages in insurance contract cases. This rationale has already been shown to create difficulties.¹¹⁶ The delayed performance standard does not pose these same difficulties. For one thing, there is no need to prove the reason for the purchase of insurance.

The bad faith breach of an insurance contract meets all of the requirements under the proposed criteria of the delayed performance standard. *Crisci v. Security Insurance Co.*¹¹⁷ illustrates this proposition. In this case, a binding contract called for non-simultaneous performance. The contract called for Crisci to fully pay all premiums on the required dates. In turn, Security Insurance agreed to defend Crisci against all lawsuits and any claims up to the agreed upon policy limit. Security Insurance was aware of the trust that Crisci placed in them, yet refused in bad faith both to defend a subsequent suit and to settle a claim against her within the policy limits. This left Crisci with no available self-help. Crisci could neither settle on

puts. These increased transaction costs then will force a party to include these costs in evaluating the efficiency of a breach. Such a change could lead to a decrease in the efficiency of the allocation of resources without requiring any evaluation of the egregiousness of the actions of the breaching party.

114. Total vulnerability, as used in this Comment, exists when one party to a contract has available no self-help remedies and the traditional contract remedies provide no protection against injuries and damages arising out of the posture and the actions of the breaching party at the time of breach.

115. See *infra* notes 146-51 and accompanying text.

116. See *supra* notes 55-65 and accompanying text.

117. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

her own due to her lack of resources, nor stop payment for all the premiums already paid. As a result, a jury verdict far in excess of the policy limits was awarded against Crisci. Therefore, her contract damages, full payment under the policy, would not put her in the position she would have been in had Security Insurance fully performed under the agreement.¹¹⁸ Security Insurance knew the insured did not have adequate means to pay the settlement prior to trial, and therefore was aware of both the vulnerability and the unavailability of adequate remedies. Yet, it clung to its bad faith premise that it had no liability under the policy. Thus, each of the elements of breach of the covenant of good faith and fair dealing under the delayed performance standard is fully satisfied in *Crisci*.

Since the delayed performance standard does not rely upon special relationship to explain tort remedies, the assignment of causes of action is more understandably allowed. The court in *Crisci* allowed an assignment of the cause of action even though damages were premised upon the loss of peace of mind.¹¹⁹ A random accident victim cannot claim to have contracted for peace of mind with an insurance carrier he has never met. Yet, under older standards, that same person can sue to receive compensation for someone else's loss of peace of mind. The proposed standard is much more straightforward. The accident victim can sue, not for another's peace of mind, but for the damages commensurate with actual damages suffered due to the breach of contract.

The delayed performance standard also explains the supreme court's recent decision in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*¹²⁰ In this case, the California Supreme Court overruled a prior holding in *Royal Globe Insurance Co. v. Superior Court*¹²¹ which allowed third parties to bring bad faith actions against insurers based upon California Insurance Code section 790.03.¹²² The court stated that the *Royal Globe* decision "promotes multiple litigation, because its holding contemplates, indeed encourages, two lawsuits by the injured claimant."¹²³ Furthermore, because *Royal Globe* did not require the existence of a binding insurance contract between the claimant and the insurer, the court stated that the claimant's ability to simultaneously sue both the insurer and the insured encourages unwarranted settlement demands.¹²⁴ Under the delayed performance standard, such third party bad faith actions would not

118. *Id.* at 428-29, 426 P.2d at 176, 58 Cal. Rptr. at 16.

119. *Id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.

120. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

121. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

122. CAL. INS. CODE § 790 (West 1979 & Supp. 1988).

123. *Moradi-Shalal*, 46 Cal. 3d at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.

124. *Id.*

be allowable, because the standard requires a binding contract between the claimant and the insurer.

B. The Banking Context

The delayed performance standard likewise provides a better rationale for extending the tortious breach of the covenant of good faith and fair dealing into the banking context, as shown in *Commercial Cotton Co. v. United California Bank*.¹²⁵ Calvin created a binding contract with United California Bank. This contract called for Calvin to deposit money in the bank, while the bank would hold that money and make it available to him later, upon demand. The bank honored a forged check, then in bad faith denied any responsibility, having no reasonable basis for their denial.¹²⁶ Calvin was left with no self-help remedies. Further, when the bank adopted a "see you in court" posture, Calvin was left only with the recourse of pursuing lengthy legal proceedings to recover what was rightfully his, even though he had notified the bank of his position and his lack of adequate remedies.¹²⁷ The focus should have been on the positions of the parties at the time of the breach and the actions and bad faith displayed by the bank. Furthermore, under the proposed standard, there would be no difference in the treatment of depositors in interest bearing versus non-interest bearing accounts.¹²⁸

C. Seaman's and Quigley — The Commercial Context

The delayed performance standard applies equally to the *Seaman's* decision.¹²⁹ The court found that Standard Oil's letter of intent to supply fuel oil was sufficient to form a specifically enforceable contract. Standard in turn knew that Seaman's was using this contract as the basis for a bid on a marine fueling station. Standard Oil further required Seaman's to seek and receive exceptions to the governmentally imposed fuel allocations, when the government later placed limitations upon the expansion of fuel distribution. Seaman's,

125. 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985). See also *supra* notes 86-90 and accompanying text.

126. See *supra* note 87 and accompanying text.

127. *Commercial Cotton*, 163 Cal. App. 3d at 518, 209 Cal. Rptr. at 556. The court awarded punitive damages in this case even though it overturned the damages for emotional distress awarded by the trial court. In this case, the contract damages were inadequate compensation for the misconduct of the bank.

128. See *supra* note 90 and accompanying text.

129. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). See also *supra* notes 39-42, 66-72 and accompanying text.

at each step, fully performed all the requisite terms of the contract and awaited Standard Oil's counter-performance. Not only did Standard Oil refuse to comply with the contract once these exceptions were granted, but it then asked the Federal Energy Commission to repeal the exception. Because of the unique situations in the petroleum industry at the time, Seaman's was left with no alternative source of fuel. Standard Oil, aware of this fact, refused to honor the contract, and in bad faith denied its existence altogether. This left Seaman's with no self-help remedies and inadequate legal remedies under the contract.¹³⁰

The delayed performance standard also explains the denial of tort damages in *Quigley v. Pet, Inc.*¹³¹ Despite the existence of a binding contract, Pet refused to comply. While there was a decided difference in the relative size of the parties to the contract, the court declined to find a tortious breach of good faith and fair dealing. Since the price was favorable to Quigley, the court reasoned that he must have assumed the risk of breach.¹³² In other areas of contract law, courts have consistently declined to review the adequacy of consideration.¹³³ Yet here, the court, at least partially, based its decision upon the amount of the contract price. If the contract price is to become a consideration for the granting of tort damages in contract actions, judges will have to display great wisdom in the appropriate relative value of all contracts. A much better analysis would show that Quigley had available to him self-help and contract remedies. Quigley was not in an absolutely vulnerable position, because he still had possession of his trucks and could seek business elsewhere to mitigate damages. If under other contracts, he did not receive the full contract price agreed to by Pet, he still retained the right to sue for the money difference.

D. The Employment Context

*Koehrer v. Superior Court*¹³⁴ demonstrates the proposed standard in the employment context. The Koehrs were suing their employers for breach of contract and the breach of good faith and fair dealing. The court carefully analyzed the history of breach of contract, tortious discharge, and breach of good faith and fair dealing. The court found that breach of contract suits were based upon the violation of an express or implied contract term. Next, it stated that tortious discharge occurred when an employer discharged an employee contrary

130. *Seaman's*, 36 Cal. 3d at 761-62, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

131. 162 Cal. App. 3d 877, 208 Cal. Rptr. 394 (1984).

132. *Id.* at 893, 208 Cal. Rptr. at 403.

133. *Horton v. Kyburz*, 53 Cal. 2d 59, 65, 346 P.2d 399, 403 (1959).

134. 181 Cal. App. 3d 1155, 226 Cal. Rptr. 820 (1986).

to public policy expressed by either the legislature or the judiciary. Finally, the court stated that the covenant of good faith and fair dealing is breached when an employer discharges an employee, and claims in bad faith that a good cause for discharge exists.¹³⁵ In its analysis, the court claimed that a number of previous decisions which were based on the breach of the covenant of good faith and fair dealing were, in reality, tortious discharge claims.¹³⁶

Under the delayed performance standard, the Koehrsers would have had the self-help remedy of seeking employment elsewhere. This would have made tort remedies under the employment contract unavailable. This result would have been consistent with both the court's rationale and holding in *Foley v. Interactive Data Corp.*¹³⁷ Instead, "[b]y this broad stroke, made without analyzing the appropriateness of imposing tort remedies in the employment context, the *Koehrer* court broached the possibility of obtaining tort damages for the breach of any term of a contract whether for employment or otherwise."¹³⁸

The *Koehrer* court failed to explain how an employer can breach an employment contract without also breaching good faith and fair dealing.¹³⁹ The employer cannot deny the existence of a valid contract or the employer will run afoul of *Seaman's*. Neither can the employer deny liability without good cause or "an action for breach of the implied covenant of good faith and fair dealing will lie."¹⁴⁰ It seems that according to *Koehrer*, there are only two limited areas in which employers can breach an employment contract without subjecting themselves to tortious damages. First, in the event that the employer asserted a good faith claim which is proven to be false, the breach might be limited to contract damages.¹⁴¹ Second, if an em-

135. *Id.* at 1163-71, 226 Cal. Rptr. at 824-29.

136. *Id.* at 1167-68, 226 Cal. Rptr. at 827 (citing *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980)).

137. 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988). *See also supra* notes 46-53 and accompanying text.

138. *Id.* at 689, 765 P.2d at 393, 254 Cal. Rptr. at 231.

139. *See Elxsi v. Kukje America Corp.*, 672 F. Supp. 1294, 1297 (N.D. Cal. 1987) (discussing the conceptual flaws of this approach to the definition of the breach of the covenant of good faith and fair dealing).

140. *Koehrer*, 181 Cal. App. 3d at 1171, 226 Cal. Rptr. at 829.

141. One of the few manners in which this might occur would be in a situation similar to *Ketchu v. Sears Roebuck & Co.*, 195 Cal. App. 3d 1596, 231 Cal. App. 581 (1986). In this case an employee failed to assert that he hit another employee in self-defense until the dispute went to trial. Had the employee asserted self-defense prior to trial, the court would likely find that the failure of an employer to properly ascertain the veracity of the cause for termination in itself would be a breach of the covenant of good

ployer discharges an employee with absolutely no reasons or claims, as absurd as it may be, they might be able to avoid tort damages.¹⁴²

Adopting the *Koehrer* standard appears to greatly benefit the employee. However, such a policy would not benefit employees as a class. If employers realized breach of contract subjects them to damages in excess of the contract amount, they would be forced to change their business practices. First, employers might decide that it is not in their interests to offer contracts to any of their employees at all. Thus, the security enjoyed by contract employees might be endangered.¹⁴³ Second, employers may also significantly limit the length of contract in an attempt to lessen exposure to tort damages. This could disrupt the stability that is provided by long-term contracts.¹⁴⁴ More likely, wages would be lessened for all contract employees to absorb the cost of increased damages paid out in the event of a claim.

If the delayed performance standard is adopted, many of these problems would be eliminated. First of all, the delayed performance standard will not alter the availability of claims for tortious discharge. The *Koehrer* court itself found that a number of prior cases based upon good faith and fair dealing were actually tortious discharge.¹⁴⁵ *Khanna v. Microdata*¹⁴⁶ provides a good example of an employee having a valid tortious breach of good faith and fair dealing claim under the delayed performance standard. Not only did

faith and fair dealing.

142. These factors are greatly amplified by the unique characteristics of labor law. First of all, employees have a limited duty to mitigate damages in the event of a breach. See *Parker v. Twentieth Century-Fox Film Corp.*, 3 Cal. 3d 176, 187, 474 P.2d 689, 696, 89 Cal. Rptr. 737, 744 (1970) (Sullivan, C.J., dissenting). Not only can discharged employees avoid mitigation, but all money paid to them under unemployment insurance cannot be used to mitigate damages. *Billetter v. Posell*, 94 Cal. App. 2d 858, 211 P.2d 621 (1947). Therefore, a terminated employee under *Koehrer* can collect unemployment, reject job offers that are not satisfactory, and still collect not only the face value of the contract, but also tort damages as well. This is combined with the protections offered under California Labor Code which provides in part for penalties, attorneys' fees in successful labor actions, continued obligation for wages when not paid at discharge, and that the Labor Commissioner is required to bring such actions on behalf of employees. CAL. LAB. CODE §§ 203-218.5 (West 1971 & Supp. 1988). All of these factors combine to put the employer at a certain disadvantage.

143. Though *Pugh* found that the remedies available to employees at will are not completely limited. *Pugh v. See's Candies*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981).

144. Cf. Trebilcock, *The Doctrine of Inequality of Bargaining Power*, 26 U. TORONTO L.J. 359 (1976) (discussing the effects that substantive unconscionability will have on the market power of employees).

145. See *supra* note 30. Another good example is found in *Rulon-Miller v. International Business Machs. Corp.*, 162 Cal. App. 3d 241, 208 Cal. Rptr. 524 (1984). In that case, the court questioned why there was no investigation into the tortious invasion of privacy even though the decision was based upon the breach of the covenant of good faith and fair dealing.

146. 170 Cal. App. 3d 250, 215 Cal. Rptr. 860 (1985).

Microdata change the employment contract, they refused to pay according to the terms of their new contract. Therefore, when Khanna sued, his employer still owed him for work that was fully performed, and Khanna was left with no self-help remedies. If Khanna could demonstrate that contract remedies were inadequate, his full performance coupled with Microdata's knowledge of his vulnerability makes tort damages available under the proposed standard. In this manner an employer can prevent an employee from receiving the benefits of an agreement. Where the employee is forced to sue both for work fully performed under the contract as well as for the future benefits of that contract, the employee is left without the self-help remedy of mitigation, for the benefits of the contract have already been conferred upon the employer.

The *Foley* decision foreclosed the availability of tort remedies for breach of the covenant of good faith and fair dealing in employment contracts.¹⁴⁷ However, its analysis focused upon the economic dilemma faced by the insured when an insurer refuses to accept a settlement offer within the policy limits. The court reasoned that, "the insured cannot turn to the marketplace to find another insurance company willing to pay for the loss already incurred."¹⁴⁸ Likewise, the discharged employee, who has not been paid for services already rendered, cannot turn to the market place and find an employer willing to pay for the work performed for another. While the discharged employee has not purchased protection from his former employer, there is a fundamental difference in the position of an employee seeking the promised payment for services already rendered.¹⁴⁹

The court found a difference between the insurance relationship and the employment relationship, which is not present when an employee is seeking payment for benefits already conferred. Typically an insurer and an insured "are financially at odds. If the insurer pays a claim it diminishes its fiscal resources."¹⁵⁰ But, "as a general rule it is to the employer's economic benefit to retain good employees,"¹⁵¹ so the "interest of employer and employee are most fre-

147. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 693, 765 P.2d 373, 396, 254 Cal. Rptr. 211, 234 (1988).

148. *Id.* at 692, 765 P.2d at 396, 254 Cal. Rptr. at 234.

149. See CAL. LAB. CODE § 203 (West 1971 & Supp. 1989) (providing that an employee's wages will continue after discharge, where an employer refuses to pay wages upon discharge).

150. *Foley*, 47 Cal. 3d at 693, 765 P.2d at 396, 254 Cal. Rptr. at 234.

151. *Id.*

quently in alignment.”¹⁵² This reasoning breaks down when the employee has already been discharged and the employer is withholding payment of back wages. In this instance, once again, the employee is cast in an economic dilemma where he or she must convince the employer to diminish its fiscal resources without any concomitant economic benefit. Therefore, while the *Foley* court did not address this particular issue, its analysis reasonably supports the availability of tort remedies where an employee has been discharged, and the employer withholds wages for work already performed.

E. Economic Analysis

Economic analysis also supports the delayed performance standard. One of the functions of contract law is to provide for an efficient allocation of resources.¹⁵³ This is one reason that courts have been reluctant to impose damages greater than the limits of a contract. Such limitation allows efficient breach. An efficient breach occurs when one party is prepared to fully compensate the other party so that the breaching party may accept a superior offer elsewhere. Under the delayed performance standard, efficient breaches are still available, since a tortious breach cannot occur without the breaching party refusing to compensate the performing party. In fact, the very concept of efficient breach is antithetical to such an opportunistic exploitation of a vulnerable party. In the event that a contract calls for non-simultaneous performance, once one party has fully performed no efficient breach can occur. Instead the non-performing party is exploiting the other's vulnerability.¹⁵⁴ So, by adopting the delayed performance standard, efficient breaches are not thwarted, only opportunism is discouraged.

This standard also eliminates a great deal of gamesmanship. It puts both parties in a position where performance pursuant to the contract is to their greatest advantage. For the early performing party, compliance with the express terms of the contract is essential. The performing party is aware that any deviation from the terms of the contract gives rise to a good faith claim on the part of the breaching party. On the other hand, the later performing party knows that mental suffering, extended consequences, and punitive damages are possibly available if he or she tries to exploit the vulnerable position of the early performing party. Further, *ex ante* notice is provided to both parties of the exact criteria which will be utilized to establish tortious breach of the covenant of good faith and fair dealing in their contract.

152. *Id.*

153. R. POSNER, ECONOMIC ANALYSIS OF LAW § 4.1 (3d ed. 1986).

154. *Id.* This is what Posner calls opportunistic breach.

Adopting this standard will not encourage early performers to leave themselves totally vulnerable. Common business sense induces every person to seek security in their agreements. It is highly unlikely that anyone will situate themselves vulnerably in order to receive tortious damages.¹⁵⁵ On the other hand, this standard takes away some of the desirability of being the late performing party, for under this standard, the late performing party will be the only one subject to tort damages for the breach of good faith and fair dealing. Therefore, he or she will know that if he or she does in fact breach the covenant of good faith and fair dealing, he or she will be liable for extended consequences, mental suffering, and possibly punitive damages.

Neither will this standard promote a large number of exorbitant or fraudulent claims. First, in order to show a valid claim the early performing party must prove that he or she has been damaged. Also, many of the concerns regarding damages in commercial contracts are unfounded.¹⁵⁶ Further, punitive damages are only available when fraud, oppression, or malice are found.¹⁵⁷ These limitations confine tort damages for the breach of the covenant of good faith and fair dealing to instances of genuine injury.

Finally, this standard both reduces the cost of information, and internalizes the costs of breach. The delayed performance standard requires that the breaching party know both of the vulnerability of the other party and of the inadequacy of his or her remedies. This compels the performing party to disclose his or her position. The party must disclose both the extent of his or her injuries as a result of the breach, and the full extent of the claim.¹⁵⁸ This allows the breaching party to evaluate the full potential cost of breach. In the

155. For example, in order to receive punitive damages, the plaintiff must prove "by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice. . . ." CAL. CIV. CODE § 3294(a) (West 1970 & Supp. 1988).

156. For example, if two large commercial firms entered into a contract calling for non-simultaneous performance, traditional contract law would provide for the contract price plus accrued interest. Under the delayed standard, the only addition to these damages will be provable consequential damages. Such damages are not likely to arise between relatively equal commercial counterparts. However, in cases such as *Seaman's*, where those damages do in fact occur, provable consequential damages would be available.

157. CAL. CIV. CODE § 3294 (West 1979 & Supp. 1988).

158. Such disclosures could have prevented the claim found in *Ketchu v. Sears Roebuck & Co.*, 195 Cal. App. 3d 1596, 231 Cal. Rptr. 581 (1986). In *Ketchu*, a long-term employee was fired for striking a fellow worker. At trial, he alleged for the first time that he struck the other man in self-defense. If this allegation had been included in any of the reports of the incident, perhaps the dispute could have been avoided.

event that the breach does in fact meet all the elements, the breaching party will then know the full cost of that breach. With this information, the breaching party will be able to weigh the cost of breach against the validity of any defense which he or she plans to assert, in order to make the most economically efficient decision. The party in the best position to know of the validity of any defense, the breaching party, will receive the information needed to fully evaluate all the potential costs of asserting defenses in bad faith.

VII. CONCLUSION

California courts have extended tortious breach of the covenant of good faith and fair dealing beyond the rationale they initially provided to support it. The standards offered by the courts are not consistent with the decisions which they have produced. These criteria offer no certainty for adjudication or precedential decisions. Quite the contrary, the law has been in a state of confusion on this issue.

The delayed performance standard proposed by this Comment offers effective criteria for the evaluation of the breach of the covenant of good faith and fair dealing. The proposed standard is based upon normative considerations of basic justice, economic concerns of efficient allocation, and pragmatic interests of adjudicative certainty. This standard emanates from a commonality which underlies the previous California decisions: non-simultaneous performance. While these prior decisions were based upon subjective criteria, the delayed performance standard explains these same decisions in an objective fashion. By utilizing legal concepts already employed in contract law, the proposed standard replaces the uncertainty currently surrounding breach of the covenant of good faith and fair dealing with a predictability which will encourage consistent litigation. The delayed performance standard will not deter contract formation, but instead will promote efficient transactions allowing efficient breaches, and provide a means for the parties to structure the contract to avoid tort damages. Yet, most importantly, it will provide a standard by which injured parties can receive adequate compensation, without promoting fraudulent claims.

DENNIS DOLLAR